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And The Winner Is . . .

After months of jockeying for position, Liberal Democratic Party secretary general Noboru Takeshita has finally emerged as the party's choice to succeed Yasuhiro Nakasone as president. Although the outcome was no surprise, the ending to this long drama had a special twist. Unable to agree on a successor, the three top candidates for the post turned to the outgoing president as a final arbitrator. With his usual flair for the dramatic, Mr. Nakasone sent his decision via his personal emissary, who revealed the choice to the three contenders -- Mr. Takeshita, Finance Minister Kiichi Miyazawa and LDP executive council chairman Shintaro Abe -- early in the morning of October 20.

Higher Yen Reins In Japan's Trade Surplus

The big drop in the dollar's trade-weighted value since February 1985 will not trim the huge U.S. trade deficit this year, Reagan administration officials and business economists have conceded in the wake of another bigger-than-expected monthly shortfall in August. In fact, few people are now willing to venture a guess about the timing of a turnaround in the red-ink trade entry, although policymakers repeatedly point out that the imbalance corrected for price changes has improved significantly since 1986's third quarter.

Japan's trade results have also defied the conventional wisdom about how fast export and import numbers should respond to exchange rate changes, but the parallels between what has happened in Japan and in this country end there. Not only is the steep run-up in the yen's value over the last two-and-one-half years moving trade flows in the right direction; there is strong evidence that the corner has been turned. For starters, Japan's trade surplus in dollar terms dropped in the July-September period for the second straight quarter after 17 quarters of back-to-back gains. Then there is the fact that the monthly imbalance has been running behind year-earlier totals since May as a result of double-digit import hikes dating back to the same time and seven consecutive months of single-digit increases in exports.

But volume figures provide the clearest proof that Japan's enormous trade surplus is indeed headed down. Price-adjusted exports, which had dipped 1.4 percent in 1986, declined every month between February and September for an additional cutback of 2.4 percent at this year's nine-month mark. At the same time, imports in volume terms continued to build on their 1986 gain of 13.3 percent, rising by an extra 6 percent through September, as stronger Japanese domestic demand reinforced the effects of the higher yen. Behind this expansion, government spokesmen note at every opportunity, were bigger purchases of foreign manufactured products -- up 6.7 percent in real terms as of August on top of a 1986 jump of 24.4 percent.

Change in Volume of Japan's Exports and Imports

	Exports	Imports
1982	-2.4%	-0.6%
1983	8.7	1.3
1984	15.4	10.7
1985	4.7	0.2
1986	-1.4	13.3
1985: I	6.9	0.6
II	6.8	-0.4
III	4.0	-2.8
IV	1.8	3.3
1986: I	-0.2	3.6
II	-0.9	16.8
III	-0.3	18.7
IV	-4.2	14.4
1987: I	-0.1	8.1
II	-3.9	3.6
III	-3.0	6.6

Japan's Total Trade in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1982	$138,831	-8.7%	$131,931	-7.9%	$6,900
1983	146,928	5.8	126,393	-4.2	20,534
1984	170,114	15.8	136,503	8.0	33,611
1985	175,638	3.2	129,539	-5.1	46,099
1986	209,151	19.1	126,408	-2.4	82,743
1985: I	38,503	-1.3	32,513	-5.7	5,991
II	43,748	0.6	32,094	-7.0	11,654
III	43,909	2.7	31,239	-8.1	12,671
IV	49,478	10.3	33,693	0.5	15,785
1986: I	45,499	18.2	33,005	1.5	12,494
II	53,166	21.5	31,424	-2.1	21,742
III	54,768	24.7	30,153	-3.5	24,615
IV	55,718	12.6	31,826	-5.5	23,892
1987: I	51,478	13.1	31,940	-3.2	19,539
II	56,946	7.1	36,357	15.7	20,589
III	57,833	5.6	38,299	27.0	19,535

Japan's Total Trade in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1982	Y34,433	2.9%	Y32,656	3.8%	Y1,776
1983	34,909	1.4	30,014	-8.1	4,895
1984	40,325	15.5	32,321	7.7	8,004
1985	41,956	4.0	31,085	-3.8	10,871
1986	35,290	-15.9	21,551	-30.7	13,739
1985: I	9,898	9.5	8,340	4.3	1,559
II	11,025	11.1	8,093	2.8	2,932
III	10,591	2.4	7,534	-8.3	3,057
IV	10,442	-5.3	7,118	-13.6	3,323
1986: I	8,674	-12.4	6,334	-24.1	2,339
II	9,119	-17.3	5,399	-33.3	3,720
III	8,632	-18.5	4,758	-36.8	3,874
IV	8,865	-15.1	5,060	-28.9	3,806
1987: I	7,962	-8.2	4,953	-21.8	3,010
II	8,156	-10.6	5,204	-3.6	2,952
III	8,504	-1.5	5,637	18.5	2,867

Japan's Trade with the United States in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1982	$36,330	-5.9%	$24,179	-4.4%	$12,151
1983	42,829	17.9	24,648	1.9	18,181
1984	59,937	39.9	26,862	9.0	33,075
1985	65,278	8.9	25,793	-4.0	39,485
1986	80,456	23.3	29,054	12.6	51,401
1985: I	13,346	6.8	6,771	1.3	6,575
II	16,837	9.0	6,641	-1.6	10,196
III	16,615	5.4	6,111	-9.8	10,504
IV	18,480	13.9	6,270	-5.7	12,211
1986: I	16,696	25.1	6,278	-7.3	10,418
II	20,921	24.3	8,305	25.1	12,616
III	21,280	28.1	7,525	23.1	13,755
IV	21,559	16.7	6,946	10.8	14,613
1987: I	18,003	7.8	6,961	10.9	11,041
II	21,187	1.3	7,589	-8.6	13,599
III	21,616	1.6	8,235	9.4	13,381

Japan's Trade with the United States in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1982	Y9,015	5.8%	Y5,991	7.9%	Y3,025
1983	10,179	12.9	5,855	-2.3	4,323
1984	14,221	39.7	6,364	8.7	7,858
1985	15,583	9.6	6,213	-2.4	9,369
1986	13,564	-13.0	4,918	-20.9	8,646
1985: I	3,429	18.3	1,737	11.9	1,692
II	4,244	20.4	1,674	8.8	2,569
III	4,008	5.2	1,474	-10.0	2,534
IV	3,903	-2.1	1,328	-18.7	2,575
1986: I	3,191	-6.9	1,203	-30.7	1,988
II	3,589	-15.4	1,421	-15.1	2,168
III	3,355	-16.3	1,190	-19.3	2,165
IV	3,429	-12.1	1,104	-16.9	2,325
1987: I	2,786	-12.7	1,080	-10.3	1,707
II	3,035	-15.4	1,085	-23.6	1,950
III	3,178	-5.3	1,212	1.9	1,966

Although the appreciation of the yen has finally reversed the growth of Japan's trade surplus, Tokyo still has a tough public relations job on its hands because the full-year 1987 number will be just shy of last year's record surplus of $82.7 billion. Through September, for example, exports topped imports by $59.7 billion -- $0.9 billion more than in the first three quarters of 1986, with overseas sales up 8.3 percent to $166.3 billion and purchases from abroad 11.3 percent higher at $106.6 billion. Tokyo's hardest campaign, however, will be convincing Washington that the bilateral surplus is contracting since the turnabout in Japan-U.S. trade only dates from mid-year. That one quarter lag virtually guarantees that the black-ink entry this year will top 1986's record $51.4 billion figure by at least a small amount.

Susan MacKnight

Tax Reform Again Heads FY 1988 Agenda

While the dust has not settled in Japan from this spring's battle to pass the most significant tax reform ever, calls for further changes have already been raised. After a bruising political battle between the ruling Liberal Democratic Party and the opposition that paralyzed the parliament for nine months, political, government and business leaders are now urging changes in other areas. These include:

- Capital gains tax - On October 8 the Ministry of Finance suggested that a modest tax on capital gains should be instituted in the interest of tax fairness and to balance the impact of the personal income-tax cuts approved in early September (see JEI Report No. 35B, September 18, 1987). The proposal is also a response to opposition party criticism that the tax system favors the rich. Currently, capital gains from stock trading are virtually tax-free because the tax threshold is very high (50 deals a year involving more than 200,000 shares). Although the threshold will drop January 1, 1988 to 30 transactions of more than 120,000 shares, most deals will still be excluded.

- Indirect tax - Despite being forced to withdraw this proposal for FY 1987, MOF, the LDP and Keidanren (the Federation of Economic Organizations) favor instituting a significant indirect tax in fiscal 1988. Beyond agreement that the tax should be broad-based, no details have been worked out. Before proceeding with legislation the government and the LDP will certainly try to prepare a broad consensus on this issue to avoid a repeat of this session's problems.

- Business taxes - In an October 14 report, Keidanren called for an overhaul of corporate income taxes, depreciation rules and other business taxes. "Equal burden sharing" should be the goal of tax reform, the business lobby argued, because Japan's society is aging and the economy is undergoing structural adjustment. The report lacked specific details, however.

- Liquor tax - Responding to complaints from foreign distillers (particularly European), MOF has proposed abolishing the ad valorem tax on liquor effective April 1, 1988; quantity-based taxes will remain, however (see JEI Report No. 20A, May 22, 1987). The system of whiskey grading will also be dropped and a new tax rate set somewhere between the current levies on special- and first-class grades. In addition, the quality classifications for wine and other liqueurs will be abolished. The number of sake (rice wine) grades will